No. 22788

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 22788

WHITE CHEMICAL COMPANY, Appellant,

v.

HENRY MORADIAN, RECEIVER in Bankrupty of CAL-ZONA FARMS, a Corporation, and Henry Moradian, Trustee in Bankruptcy, Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

APPELLANT'S OPENING BRIEF

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I N D E X

TABLE OF CASES AND AUTHORITIES

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APPELLANT'S OPENING BRIEF

STATEMENT OF PLEADINGS AND FACTS DISCLOSING BASIS OF JURISDICTION

The United States District Court for the District of Arizona had jurisdiction over this case by reason of it being a bankruptcy proceeding, and in particular, under 11 U.S.C. § 11(a)10. This was by reason of a Petition for review of Findings of Fact, Conclusions of Law and Order made, found and entered by the Referee in Bankruptcy in the matter of Cal-Zona Farms, a corporation, Bankrupt, which was bankruptcy proceeding No. B-11511-Phx. in the United States District Court for the District of Arizona.

Jurisdiction over this appeal is vested in the Court of Appeals of the United States and in the Ninth Circuit thereof by virtue of 11 U.S.C. § 47.

The order of the Referee in Bankruptcy is set forth in the Transcript of Record, beginning at page 139,

through and including page 149. The order of the United States District Court, issued on the Petition for Review, is set forth in the Transcript of Record beginning at page 196 through page 204. The Petition for Review is set forth in the Transcript of Record beginning at page 150.

STATEMENT OF THE CASE

On July 16, 1964, Cal-zona Farms, a corporation, the bankrupt herein, filed, in the United States District Court for the District of Arizona, a petition proposing an arrangement under Chapter XI of the Bankruptcy Act of the United States (Transcript of Record, page 4).

On October 26, 1964, the Receiver in the Chapter XI proceedings issued a Certificate of Indebtedness to Southwest Forest Industries, Inc., pursuant to an order of the Referee in Bankruptcy (Transcript of Record, pages 141-42). Such Certificate of Indebtedness was authorized to be issued with precedence and priority over the expenses of administration.

On August 20, 1964, the Receiver issued a Certificate of Indebtedness to Producers Cotton Oil of Arizona, on the condition that such certificate should have

precedence and priority over the expenses of administration (Transcript of Record, page 143).

There is still due and owing to Southwest Forest Industries, Inc., which is still the owner and holder of the above described Certificate of Indebtedness, the sum of $50,000 (Transcript of Record, page 142).

There is still due and owing to Producers Cotton Oil Company, successor to Producers Cotton Oil of Arizona, under the above described Certificate, the sum of $16,777.84 (Transcript of Record, page 143).

The appellant, White Chemical Company, a corporation, delivered to the debtor corporation, and now bankrupt, Cal-Zona Farms, goods and services employed by the Receiver in the growing of a crop, which said goods and services had a reasonable value of $28,451.28. No Certificate of Indebtedness was issued to White Chemical Company, and all goods and services were delivered during the pendency of the proposed arrangement under Chapter XI, and were delivered at the instance and request of the Receiver for the purpose of aiding in growing of an existent crop. There is now due and owing to White Chemical Company the sum of $28,451.28 (Transcript of Record, pages 143-44).

The Referee concluded as a matter of law that Southwest Forest Industries, Inc., had a Certificate of Indebtedness validly issued under § 344 of the Act relating to bankruptcy (11 U.S.C. § 744) and concluded further that Southwest Forest Industries, Inc., is entitled to priority in payment over other expenses of administration of the proposed arrangement under Chapter XI, subject only to the payment of fees and costs incurred in the administration of the ensuing bankruptcy, and that there is due and owing to Southwest Forest Industries, Inc., $50,000 under the Certificate (Transcript of Record, page 146).

The Referee further concluded as a matter of law that Producers Cotton Oil Company was validly issued a Certificate of Indebtedness under § 344 of the Act relating to bankruptcy (11 U.S.C. § 744) and that it is entitled to priority in payment over the other expenses of administration of the proposed arrangement under Chapter XI, subject only to the payment of fees and costs incurred in the administration of the ensuing bankruptcy, and that the amount due and payable to Producers Cotton Oil Company is the sum of $16,777.84 (Transcript of Record, page 147).

The Referee further concluded that the claim of White Chemical Company in the sum of $28,451.28 is allowable as a cost of administration of the Chapter XI proceedings which was superseded by the bankruptcy (Transcript of Record, page 147).

The court, acting through the Referee, further concluded that in its discretion the claimants of administrative expenses are not entitled to equitable relief so that they, including appellant White Chemical Company, may participate on an equal basis with the holders of the Receiver's Certificates of Indebtedness in the distribution of the funds of the estate, and that they, including appellant White Chemical Company, are entitled to participate in the distribution of the assets of the estate, only after payment in full of the fees and expenses to the Trustee, Receiver, their attorneys and accountant, and after the payment in full of the amount due on the Receiver's Certificates of Indebtedness (Transcript of Record, pages 147-48).

There are inadequate funds to pay the Trustee, the Receiver, their attorneys and accountant, the Certificates of Indebtedness and the other costs of administration, including appellant.

SPECIFICATIONS OF ERROR

Specified Error No. 1

The Bankruptcy Court below was in error in Conclusion of Law No. 1 (Transcript of Record, page 145) since it did not distinguish between costs of administration in the Chapter XI arrangement proceedings and the ensuing bankruptcy proceedings and allowed the Receiver's fees and expenses and fees and expenses of the attorney for the Receiver, both in the Chapter XI proceedings, to be on a parity with the fees and expenses of the Trustee, attorney for Trustee, attorney for bankrupt and accountant, in the ensuing bankruptcy proceedings, for the reason that § 64(a)1 of the Bankruptcy Act, as amended [11 U.S.C. § 104(a)1], places all costs of administration on a parity except that costs of administration of an ensuing bankruptcy proceeding shall have priority in advance of payment of unpaid costs and expenses of administration incurred in the superseded Chapter proceeding.

Specified Error No. 2

The Bankruptcy Court below was in error in Conclusion of Law No. 3 (Transcript of Record, page 146)

for the reason that the court concluded that the certificate holder, Southwest Forest Industries, Inc., is entitled to priority in payment of its Certificate of Indebtedness for a loan representing expenses incurred in administration of the proposed arrangement under Chapter XI of the Bankruptcy Act, as amended, for the reason that § 64(a)1 of the Bankruptcy Act, as amended [11 U.S.C. § 104(a)1], places all costs of administration on a parity except that costs of administration of an ensuing bankruptcy proceeding shall have priority in advance of payment of unpaid costs and expenses of administration incurred in the superseded Chapter proceeding.

Specified Error No. 3

The Bankruptcy Court below was in error in Conclusion of Law No. 4 (Transcript of Record, page 147) for the reason that the court concluded that the certificate holder, Producers Cotton Oil Company, is entitled to priority in payment of its Certificate of Indebtedness for a loan representing expenses incurred in administration of the proposed arrangement under Chapter XI of the Bankruptcy Act, as amended, for the reason that § 64(a)1 of the Bankruptcy Act, as amended [11 U.S.C.

§ 104(a)1], places all costs of administration on a parity except that costs of administration of an ensuing bankruptcy proceeding shall have priority in advance of payment of unpaid costs and expenses of administration incurred in the superseded Chapter proceeding.

Specified Error No. 4

The Bankruptcy Court below was in error in Conclusion of Law No. 5 (Transcript of Record, page 147) since it limited pro rata distribution of the funds of the estate to Southwest Forest Industries, Inc., and Producers Cotton Oil Company, and did not include therein other costs of administration incurred and unpaid under the superseded Chapter XI proceedings, and did not distinguish between the fees and costs of Trustee, Receiver, attorneys and accountant between the superseded Chapter proceeding and the ensuing bankruptcy proceeding for the reason that § 64(a)1 of the Bankruptcy Act, as amended [11 U.S.C. § 104(a)1], places all costs of administration on a parity except that costs of administration of an ensuing bankruptcy proceeding shall have priority in advance of payment of

unpaid costs and expenses of administration incurred in the superseded Chapter proceeding.

Specified Error No. 5

The Bankruptcy Court below was in error in Conclusion of Law No. 7 (Transcript of Record, pages 147-48), since it did not permit the pro rata participation of the appellant and other claimants for costs of administration in the Chapter XI proceedings superseded by the ensuing bankruptcy proceedings on an equal basis with all other incurred and unpaid costs of administration of the superseded Chapter XI proceedings, including the holders of the Certificates of Indebtedness, for the reason that § 64(a)1 of the Bankruptcy Act, as amended [11 U.S.C. § 104(a)1] places all costs of administration on a parity except that costs of administration of an ensuing bankruptcy proceeding shall have priority in advance of payment of unpaid costs and expenses of administration incurred in the superseded Chapter proceeding.

Specified Error No. 6

The Bankruptcy Court below was in error in entering the order it entered based upon the Conclusions

of Law specified as error in the above set forth specifications of error, which said order is set forth in the Transcript of Record, pages 148 and 149, and that this is for the reasons set forth in the foregoing and preceding specified errors Nos. 1-5.

Specified Error No. 7

The Bankruptcy Court below was in error in establishing priority of payments in the Opinion and Order of the District Court on review, as the same are set forth in such Opinion and Order in the Transcript of Record, page 198, at line 5 through line 17, for the reason that such established order of priority is contrary to § 64(a)1 of the Bankruptcy Act, as amended [11 U.S.C. § 104(a)1], which places all costs of administration on a parity except that costs of administration of an ensuing bankruptcy proceeding shall have priority in advance of payment of unpaid costs and expenses of administration incurred in the superseded Chapter proceeding.

A R G U M E N T

A summary of the appellant's position can most concisely be set forth to be that the appellant claims that the Bankruptcy Court below was in error when it failed to provide for distribution of the balance of the assets of the bankrupt estate as follows. The costs of administration of the ensuing bankruptcy of Cal-Zona Farms, Inc., and in particular the Trustee's fees, the Trustee's attorney, the attorney's fees for the bankrupt's attorney, and the accountant's fees for the Trustee's accountant, are entitled to priority payment under the applicable statutory priority of payments since these are costs of administration of an ensuing bankruptcy after a superseded Chapter proceeding.

After the payment of the costs of administration of the ensuing bankruptcy, it is the position of the appellant that at that point all incurred and unpaid costs of administration of the superseded Chapter XI proceedings are on a parity and should share pro rata in the balance of the funds available for distribution towards the costs of administration of such superseded Chapter proceeding. This is for the reason that it is submitted that the Bankruptcy Court below has no authority,

either by statute or by equitable principles, to establish sub-priorities within a congressionally established priority, as is set forth in § 64(a)1, 11 U.S.C. § 104(a)1.

There is no question of the authority of the Bankruptcy Court to authorize the issuance of Certificates of Indebtedness in the course of a Chapter XI bankruptcy arrangement proceeding. Section 344 (11 U.S.C. § 744) provides as follows:

> "During the pendency of a proceeding for an arrangement, or after the confirmation of the arrangement where the court has retained jurisdiction, the court may upon cause shown authorize the receiver or trustee, or the debtor in possession, to issue certificates of indebtedness for cash, property, or other consideration approved by the court, upon such terms and conditions and with such security and *PRIORITY IN PAYMENT OVER EXISTING OBLIGATIONS AS IN THE PARTICULAR CASE MAY BE EQUITABLE*." (Emphases added)

The above emphasized language of the statute seems absolutely clear to the effect that the equities to be considered are only to be considered in establishing a priority of the Certificates of Indebtedness over existing obligations. It is respectfully submitted that under no reasonable interpretation of the statutory language is there authority to establish a priority for

the certificate holder over another class of claimant whose priority has been established by Congress.

In the case of *In re Columbia Ribbon Co.*, 117 F.2d 999 (3d Cir. 1941), in interpreting § 64, §§ a [11 U.S.C. § 104(a)], as amended, which has been amended on approximately five occasions since that date for purposes which do not appear to the appellant to be destructive of the language of the Third Circuit in that case, other than as hereinafter set forth, it was stated at 1001

> ". . . . It follows that the Court in determining the priority of claims against the estate is bound by the provisions of Section 64, sub. a, as amended, 11 U.S.C.A. § 104, sub. a, which specify the classes of debts which are to have priority of payment over general creditors of a bankrupt estate and the order of their payment with respect to each other. Five classes of debts having priority are established. The first class includes 'the costs and expenses of administration.' *SINCE CONGRESS HAS SET UP NO ORDER OF PRIORITY WITHIN THE FIRST CLASS THE COURT MAY NOT FIX PRIORITIES WITHIN THE CLASS.* Missouri v. Ross, 299 U.S. 72, 57 S.Ct. 60, 81 L.Ed. 46; Missouri v. Earhart, 8 Cir., 111 F.2d 992, certiorari denied 61 S.Ct. 43, 85 L.Ed. . . . *CONSEQUENTLY ALL ADMINISTRATION EXPENSES, WHETHER INCURRED DURING THE REORGANIZATION PERIOD OR DURING THE LIQUIDATION PERIOD AND WHETHER FOR COSTS AND EXPENSES OR FOR SERVICES, MUST SHARE PRO RATA IN THE FUNDS AVAILABLE FOR PAYMENT.*" (Emphases added)

The Court further states in that case at page 1002

> ". . . . It is well settled, as the Circuit Court of Appeals for the Fourth Circuit pointed out in Westall v. Avery, 171 F. 626, 628, 'that bankruptcy proceedings themselves are purely equitable in their character, and, within the limits prescribed by the Bankruptcy Act [11 U.S.C.A. § 1 et seq.] and the special rules of practice prescribed by the Supreme Court, are to be administered in accord with the general principles and practices of equity.' See Local Loan Co. v. Hunt, 292 U.S. 234, 54 S.Ct. 695, 78 L.Ed. 1230, 93 A.L.R. 195. But these equitable powers are to be exercised within the limits laid down by the Bankruptcy Act and subject to its specific provisions. In re Concentrated Products Corp., 3 Cir., 38 F.2d 745. *THE COURT MAY NOT BY GRANTING A PRIORITY WHICH IT DEEMS EQUITABLE SET ASIDE THE CLEAR CONGRESSIONAL MANDATE THAT NO SUCH PRIORITY SHALL BE ACCORDED.*"
> (Emphases added)

Section 64(a) of the Bankruptcy Act, as amended [11 U.S.C. § 104(a)], provides

> "§ 104. Debts which have priority
>
> (a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, . . . Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of

> payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; . . . ."

As is evident, Congress has now established a sub-priority within subsection a(1) of § 64. By Congress having given priority to costs of administration of an ensuing bankruptcy after a terminated chapter proceeding, it is quite evident that Congress has intended this and this alone as the only priority among the various costs of administration that are incurred in the course of bankruptcy proceedings. It is therefore submitted that the *Columbia Ribbon Co.* case, *supra*, is still good law except as modified by Congress.

The Eighth Circuit had occasion to decide upon the establishment of sub-priorities within a congressionally established priority in the case of *Home Indemnity Co. v. Donovan Painting Co., Inc.*, 325 F.2d 870 (8th Cir. 1963). In that case the Eighth Circuit stated, at page 875

> ". . . . To be sure, abundant authority can be found to support the proposition that *a court cannot disregard the priority classifications established by statute and 'set up a subclassification of claims within a class given equal*

> *priority by the Bankruptcy Act and fix an order of priority for the sub-classes according to its theory of equity.'* In Re Columbia Ribbon Co., 3 Cir., 117 F.2d 999, 1002 (1941). See also Missouri v. Ross, 299 U.S. 72, 57 S.Ct. 60, 81 L.Ed. 46 (1936); In Re Delaware Hosiery Mills, 3 Cir., 202 F.2d 951, 953 (1953); Collier on Bankruptcy, §§ 64.02(4); 64.401(2); 65.06, p. 2293 (14th ed. 1956). However, it is likewise true that the Act does not establish inexorable rules for distribution which can never be deviated from in the interest of justice and equity. Goldie v. Cox, 8 Cir., 130 F.2d 695, 699-700 (1942); Bird & Sons Sales Corporation v. Tobin, 8 Cir., 78 F.2d 371, 373-374, 100 A.L.R. 654 (1935); Sampsell v. Imperial Paper Corp., 313 U.S. 215, 219, 61 S.Ct. 904, 85 L.Ed. 1293 (1941); Pepper v. Litton, 308 U.S. 295, 303-305, 60 S.Ct. 238, 84 L.Ed. 281 (1939); Costello v. Fazio, 9 Cir., 256 F.2d 903, 909-910 (1958); Wheeling Valley Coal Corporation v. Mead, 4 Cir., 171 F.2d 916, 920-921 (1949); Bank of America Nat. Trust & Sav. Ass'n v. Erickson, 9 Cir., 117 F.2d 796, 798 (1941); In Re Aktiebolaget Krueger & Toll, 2 Cir., 96 F.2d 768, 770 (1938). It should be pointed out that *most of these cases involve complete disallowance or subordination of a claim asserted by a creditor guilty of some fraudulent or at least questionable tactic*, whereas, here, the United States has a legitimate claim and is guilty of no such conduct."
>
> (Emphasis added)

In the case of *In re Delaware Hosiery Mills, Inc.*, (Appeal of Northwestern Nat'l Bank in Philadelphia), 202 F.2d 951 (3d Cir. 1953), the Court stated at 953

". . . . Of course, it may be possible for the receivers' certificate or the authorization of the Court to provide terms for priority or subordination of the loan--generally provision is made either for parity with other expenses of administration or subordination to same.[6] . . .

"fn 6. Research has not disclosed any case where there was a provision that the certificate or loan had priority over expenses of administration."

In the case of *In the Matter of A. M. Townson & Co., Bankrupt,* 283 F.2d 449 (3d Cir. 1960), Circuit Judge Kalodner, in a dissenting opinion stated at 461 of the opinion

". . . . Under Section 64, sub. a(1) of the Bankruptcy Act court-authorized loans made to receivers to finance their operations are in the category of 'the actual and necessary costs and expenses of preserving the estate' and are accorded first priority as an 'expense of administration'."

In the case of *Miller v. Sulmeyer,* 299 F.2d 102 (9th Cir. 1962), this Court, speaking through Circuit Judge Barnes, at that time stated at page 104

"[2] It is true that a bankruptcy court has the power to subordinate a claim which is tainted with fraud or other improper conduct when equitable principles dictate the claim should not be allowed to participate on a parity with those of other creditors. But here there is no fraud."

Finally, in what it is respectfully submitted is highly persuasive, if not controlling, upon the case at bar, is the case of *Nicholas v. United States,* 384 U.S. 678, 86 S. Ct. 1674 (1966), wherein Mr. Justice Stewart delivered the majority opinion of the Court, and the dissent appears to be as to an aspect of the case other than the one presented in this case; at page 691 of the U. S. Report and page 1683 of the Supreme Court Reporter, the Supreme Court stated

> "We need not here determine whether, with regard to the *principal* of those taxes, the general language of §7501(a) overrides the strong policy of §64a(1) of the Bankruptcy Act, *WHICH ESTABLISHES A SHARPLY DEFINED PRIORITY THAT PLACES ALL EXPENSES OF ADMINISTRATION ON A PARITY,* including claims for taxes. Cf. Guarantee Title and Trust Co. v. Title Guaranty & Surety Co., 224 U.S. 152, 32 S.Ct. 457, 56 L.Ed. 706; Davis v. Pringle, 268 U.S. 315, 45 S.Ct. 549, 69 L.Ed. 974; Missouri v. Ross, 299 U.S. 72, 57 S.Ct. 60, 81 L.Ed. 46."
> (Emphases added)

It is respectfully submitted, in summary of the above set forth statutory authority and case law authority, that under the case of *In the Matter of A. M. Townson & Co., Bankrupt, supra,* the monies borrowed from Producers Cotton Oil Company and Southwest Forest Industries, Inc., are properly classified

as expenses of administration.

It is not conceded but, however, there may be some limited authority to the effect that when a creditor or claimant is guilty of some fraudulent or at least questionable tactic, or his conduct is tainted with fraud, that then the Bankruptcy Court in the application of equitable principles could subordinate that claim. *Home Indemnity Co. v. Donovan Painting Co., Inc., supra,* and *Miller v. Sulmeyer, supra.* But as this very Circuit Court stated in *Miller v. Sulmeyer, supra,*

"But here there is no fraud."

The Court's attention is specifically directed to the footnote in the case of *In re Delaware Hosiery Mills, Inc., supra,* where that Court indicated that research had disclosed no case where a certificate or loan had priority over expenses of administration.

In the case of *In re Columbia Ribbon Co., supra,* the Court, without equivocation, stated that when Congress had established priorities, this manifested an intention to have no sub-priorities within those established by the congressional enactment.

The applicable law to the case at bar, § 64(a)1

of the Bankruptcy Act, as amended [11 U.S.C. § 104(a)1], has established one sub-priority, namely, the costs of administration of an ensuing bankruptcy proceeding which supersedes a Chapter proceeding, and then the priority is only to the extent that the costs of administration of the superseded Chapter proceeding have been incurred and are unpaid.

In the case at bar, the Certificates of Indebtedness, even though issued in the form that they were, cannot contravene the statute authorizing their issuance. Section 344 of the Bankruptcy Act, as amended (11 U.S.C. § 744), authorizes the issuance of the certificates

> "upon such terms and conditions and with such security and *PRIORITY IN PAYMENT OVER EXISTING OBLIGATIONS* as in the particular case may be equitable."
> (Emphases added)

It is submitted that the claim for costs of administration of the appellant, which was found by the court to be a cost of administration, Conclusion of Law No. 6 (Transcript of Record, page 147), must be treated on a parity with the Certificates of Indebtedness since all three claimants hold claims for costs of administration incurred in a superseded Chapter proceeding.

As the Supreme Court of the United States stated in *Nicholas v. United States, supra,*

> "Section 64a(1) of the Bankruptcy Act . . . establishes a sharply defined priority that places all expenses of administration on a parity, . . ."

By reason of the foregoing, it is respectfully submitted that this case should be remanded to the Bankruptcy Court below under direction that the costs of administration of the ensuing bankruptcy proceeding should first be paid and that thereafter the balance of the bankrupt estate should be distributed pro rata among all other validly existing claims for costs of administration, incurred but not paid, in the superseded Chapter XI proceeding.

Respectfully submitted,

McKESSON, RENAUD, COOK, MILLER & CORDOVA

By /s/ Joseph B. Miller
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Attorneys for Appellant

CERTIFICATE OF COUNSEL

I certify that in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those Rules.

/s/ Joseph B. Miller

Joseph B. Miller

AFFIDAVIT OF SERVICE BY MAIL

JOSEPH B. MILLER, being duly sworn, says that he deposited three (3) copies of the foregoing Appellant's Opening Brief in final printed form in the United States Post Office in the City of Phoenix, State of Arizona, enclosed in envelopes duly addressed as follows:

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Postage on the foregoing mailings was fully prepaid; he further states that he deposited twenty (20) copies in the United States Post Office in the City of Phoenix, State of Arizona, duly addressed to the Office of the Clerk, U. S. Court of Appeals for the Ninth Circuit, San Francisco, California 94101.

All mailings were made on the 20th day of June, 1968.

/s/ Joseph B. Miller

Joseph B. Miller

Subscribed and sworn to before me
this 20th day of June, 1968.

[SEAL]

/s/ Catherine F. Howard

Notary Public

My commission expires:
September 29, 1971